Too Little, Too Late?

Max Walsh described Paul Keating's *One Nation* package as "crude and dangerous pork-barreling dressed up as an economic strategy". (*Sydney Morning Herald*, 27.2.92.) In fact, there are aspects of *One Nation* which signal an overall resurrection of interventionist thinking. Yet it is not the spending spree which some of its critics suggested. Quite the contrary: if it errs, it is on the side of miserliness.

The facts of *One Nation* are now well known. $2.3 billion is being outlayed in government spending, taxation incentives to business to encourage capital formation and tax cuts in the future (targeted at middle income earners). The stimulus is small and spread out over at least four years. The first impact will occur as low income earners are given direct cash payments (totalling $317 million over 1992-93). In total, the current spending increases for 1992-93 are only $500 million above the August 1991 Budget estimate.

A major problem facing Australia is the decline in public infrastructure over the last decade or more. Thus, it is good that *One Nation* targets spending to public infrastructure development. Yet, while essential, this spending should not be at the expense of direct job creation. The planning delays and the need for capital suggests that these projects will provide few direct jobs (only 21,100 over three years). Further private involvement in public infrastructure expansion is encouraged by the tax-free development bonds which allow the private sector to raise funds by issuing bonds whose interest payment will attract no taxation. Other incentives to private capital formation, like accelerated depreciation allowances, are given and bring Australian business taxation rules into line with international practice.

Like the November jobs statement which was, in fact, a statement about training, *One Nation* erroneously sees the major problem in the labour market as being structural (wrong skills and/or location of skills) requiring more training provision. This ignores the fact that demand-deficient unemployment predominates in Australia. That is, people are largely unemployed because there are not enough jobs, not because they have inadequate skills. Training is wasteful in these circumstances. Direct job creation is the answer to demand-deficient unemployment. That said, the allocation for vocational training for the long-term unemployed is a good thing.

The bulk of the remaining money allocated to labour market programs will provide wage subsidies under Jobstart to help disadvantaged workers. Advocates of small government and free markets prefer wage subsidies to direct job creation because they place the employment in the private sector. Yet there are at least four reasons why wage subsidies should not be introduced as an alternative to direct job creation. First, wage subsidies are based on the assumption that unemployment is due to excessive real wages, rather than lack of aggregate demand. Second, the response of employment to real wage changes is very low, which reduces the effectiveness of the subsidy. Third, firms have an incentive to dismiss marginal staff in order to hire staff who attract the subsidy. Fourth, they are a disguised form of industry policy providing indiscriminate assistance to the private sector. From the perspective of long-term productivity improvement such assistance should be more carefully targeted.

Unemployment is a macroeconomic inefficiency. The costs in lost GDP alone are huge and dwarf the losses from micro inefficiencies. The latter have preoccupied both the government and the federal Opposition. What has been ignored is that the path to sustained economic growth, low unemployment and high productivity growth is largely determined by macroeconomic policy (the maintenance of strong levels of aggregate consumption and investment spending); microeconomic policy is simply a bit part actor.

In a recent Evatt Foundation publication, *Economic Policy in Crisis: A Proposal for Jobs and Growth* (co-authored by Roy Green, Martin Watts and myself), we outlined a three-point strategy to combat high unemployment: immediate job creation, trade policies designed to ease the balance of payments constraint on growth, and longer term industry policies with investment planning designed to avoid the resource waste of the 1980s.

Careful modelling indicated that for $2 billion, 239,000 jobs could be created almost immediately. The net cost would only be $1.26 billion due to reduced outlays on unemployment benefits and increased tax revenue. The job creation would quickly increase consumer and investor confidence, while lessening the social costs associated with high unemployment and low household income. The goal of direct job creation should be to provide temporary jobs, so that as the economy expands workers can be reabsorbed into permanent jobs.

But unless export growth is stronger and/or the propensity to import is reduced, any GDP growth will quickly exacerbate our current account and external debt problems as import spending increases. The trade policies we proposed recognise the external constraints on GDP growth. Our trade fundamentals (our export performance in relation to our import propensity) are poor. Projections of export growth and the requirements of external debt stabilisation suggest there is very little scope for domestic expansion. This trade constraint must be tackled simultaneously with the expansionary job creation by exchange rate reduction, through export subsidies (and tax credits for exports), and through import controls.

In this context, *One Nation* is a major disappointment. It does not create

Graphic: Neil Hardie

many jobs in the short run, it makes little reference to exchange rate policy, and it avoids recognition of the tight balance of payments constraint on domestic growth. The recession was engineered by restrictive policy to bring our GDP growth back in line with our trade position. Following this logic (but not accepting it), we might ask: what has changed in our trade position to justify a reversal of growth? The answer is: nothing. *One Nation*, for political reasons, simply ignores this critical issue.

The arithmetic underlying the statement is disturbing. From 1992 to 1996, GDP growth is expected to average 4.3% per annum. Similarly, employment growth from 1992 to 1996 is expected to average 2.9% per annum. These projections are similar to the actual growth achieved between June 1983 and June 1990 when we experienced large increases in foreign debt and persistently high inflation. Why will the next period of growth be any different in the absence of accompanying measures designed to improve our trading fundamentals? There are only miserly boosts ($13 million over four years) to the export sector in *One Nation* (for example, the expansion of AUSTRADE and the expansion of the Export Access Programme). The implicit hope is that the current account problems will be overcome by substantial growth in domestic savings, as the Budget goes into surplus (at higher employment levels) and its borrowing requirements decline.

We should be clear, however, that there is no contest when *One Nation* is compared to the Opposition's *Fightback!* alternative. Disastrous consequences would follow an embrace of the *Fightback!* proposal. The one guaranteed result would be the relative impoverishment of a majority of the population and increased fortunes for the top 20% or so income earners.

Yet, while *One Nation* is superior to *Fightback!*, the perceived political gains made by *Fightback!* when Hawke and Keating were squabbling over the leadership, have adversely influenced the shape of *One Nation*. The least desirable aspects of *One Nation* have emerged as a result of its status as a political response to *Fightback!* rather than as a coherent expansionary package. The proposed tax cuts, a significant proportion of the total dollar value of *One Nation*, are an example of this. They match Hewson's proposed cuts without the acid of the GST. While politically astute, they have little economic justification. They will provide no immediate stimulation (they start in July 1994) and do not help the poor in any way. One of the criticisms of interventionist stabilisation policy relates to the difficulty of timing. So a tax cut of the size suggested in July 1994 may coincide with a strongly growing economy which could then overheat. The stimulus is needed now, not in two years' time.

By implication, to provide the tax cuts and retain fiscal neutrality would require offsetting cuts in government spending. This is the long-term problem with politically motivated tax cuts; they reduce the flexibility of fiscal policy and force the public sector into relative contraction. Intervention requires tax and spending flexibility in both directions. So, while *One Nation* signifies a partial return to interventionist policy, its main problem is that too little is allocated to the wrong things. What is needed is an immediate and direct stimulus which should then be followed by medium term initiatives like training and public infrastructure development. The amount of cash which we could reasonably label as short-term stimulation is so small that it will have limited impact.

Further, to the extent that the economy will expand as a result of the statement, there is little evidence that the trade problems which brought us unstuck in our last phase of expansion have been solved. The only consistent policy mix involves stimulatory policies which are accompanied by policies which directly address the trade problems. In this way the expansionary program will have room to move. At present there is very little scope for unemployment reduction. Perhaps we should be thankful that *One Nation* is so miserly. Otherwise, given the current obsession with tax cuts, a renewed bout of high interest rates could be in store.

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